

**Letter of Findings Number: 09-0139**  
**Income Tax**  
**For Tax Year 2006**

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**ISSUES**

**I. Adjusted Gross Income Tax—Apportionment.**

**Authority:** Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981); Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); 15 U.S.C. § 381; IC § 6-3-2-2; IC § 6-8.1-5-1; [45 IAC 3.1-1-38](#).

Taxpayer protests the adjustment of its Indiana apportionment factor.

**II. Tax Administration—Negligence Penalty.**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayer is an out-of-state corporation. As the result of a review of Taxpayer's 2006 Indiana adjusted gross income tax return, the Indiana Department of Revenue ("Department") determined that Taxpayer had not used the correct apportionment percentage to determine its Indiana adjusted gross income tax. The Department issued a proposed assessment for adjusted gross income tax, ten percent negligence penalty, and interest. Taxpayer protests that it used the correct apportionment percentage and that the proposed assessments are incorrect. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Adjusted Gross Income Tax—Apportionment.**

**DISCUSSION**

Taxpayer protests the imposition of adjusted gross income tax for the tax year 2006. Taxpayer protests that it did not have nexus with Indiana for that year and therefore its apportionment percentage was zero. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The adjusted gross income tax is imposed under IC § 6-3-2-2, which states in relevant part:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter) only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.

...

Further, [45 IAC 3.1-1-38](#) provides:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:

- (1) Maintenance of an office or other place of business in the state
- (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
- (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution

- (4) Rendering services to customers in the state
- (5) Ownership, rental or operation of a business or of property (real or personal) in the state
- (6) Acceptance of orders in the state
- (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.

As stated in Regulation 6-3-2-2(b)(010) [\[45 IAC 3.1-1-37\]](#), corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of [IC 6-3-2-2\(b\)-\(n\)](#).

(Emphasis added.)

Of relevance here is 15 U.S.C. § 381 (Public Law 86-272), which prohibits states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those activities exceed the mere solicitation of sales.

The Indiana Supreme Court explained in *Indiana Dep't. of Revenue v. Kimberly-Clark Corp.*, 416 N.E.2d 1264 (Ind. 1981):

Public Law 86-272 (15 U.S.C.A. § 381), in pertinent part is as follows:

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Id. at 1265.

The Court then explained:

We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities [are] closely related to the eventual sale of a product." Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of "solicitation."

Id. at 1268.

The United States Supreme Court explained its standard for determining "solicitation of sales" in *Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992). In *Wrigley*, the Court explained:

We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. *National Tires, Inc. v. Lindley*, 68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e. g., *Herff Jones Co. v. State Tax Comm'n*, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967) (no § 381 immunity for sales representatives' collection activities). Id. at 228-30.

The Court further explained:

By contrast, *Wrigley's* in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which *Wrigley's* regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [*Wrigley's*] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee -- some company ombudsman, so to speak -- if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases. Finally, *Wrigley* argues that the various nonimmune activities, considered singly or together, are de minimis. In particular, *Wrigley* emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007 [percent] of *Wrigley's* annual Wisconsin sales, and in absolute terms amounted to only several

hundred dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.

Id. at 234-5.

Therefore, the Department may look at a taxpayer's Indiana activities as a whole to determine if the activities as a whole exceed the protection of Public Law 86-272.

After review of the materials provided by Taxpayer as part of the protest process, Taxpayer has established that it did not exceed mere solicitation in Indiana. All other activities regarding its Indiana customers were conducted in other states. Since Taxpayer had zero Indiana adjusted gross income for 2006, due to lack of nexus, the numerator in apportionment percentage calculations is zero. The result of such a calculation is that Taxpayer's apportionment percentage for 2006 was zero, as reported on Taxpayer's original return. Taxpayer has met the burden of proving the proposed assessment wrong, as required by IC § 6-8.1-5-1(c).

#### **FINDING**

Taxpayer's protest is sustained.

#### **II. Tax Administration—Negligence Penalty.**

#### **DISCUSSION**

Taxpayer protests the imposition of ten percent negligence penalty. Taxpayer states that it reported correctly with its original 2006 Indiana income tax return.

The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer has been sustained on the underlying tax discussed above in Issue I. Since Taxpayer has been sustained, and since there are no other issues or liabilities associated with Taxpayer for 2006, Taxpayer has demonstrated that it was not negligent in its tax duties.

#### **FINDING**

Taxpayer's protest is sustained.

#### **CONCLUSION**

Taxpayer is sustained on Issue I regarding adjusted gross income tax. Taxpayer is sustained on Issue II regarding negligence penalty.

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